

Financial

Frank Payton, Jr.

24 Years of Service

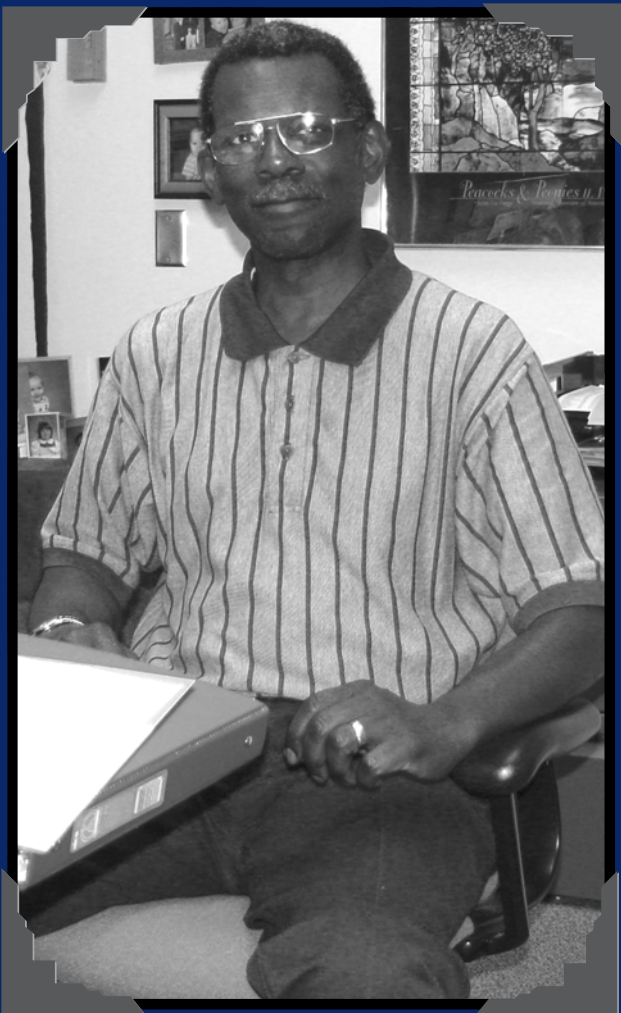
Instrumental Music

District 535 in Granville and

McLean County Unit 5 in Normal



Photos by TRS Communications



Frank, who has taught 5th through 12th grade band, has particularly enjoyed directing small ensembles and teaching marching band camp.

Many of Frank's students have gone on to be teachers and principals, and a handful are now band teachers.

Frank has served his country since 1968, with four years of active service, and is the Band Superintendent of the Air National Guard Band of the Midwest in Peoria.

Upon his retirement in 2007 or 2008, Frank plans to travel and photograph farm scenes and old barns. He will miss the students, staff, and the enjoyment of passing on knowledge.

McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report

Honorable William G. Holland
Auditor General
State of Illinois

Board of Trustees
Teachers' Retirement System of
The State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying statement of plan net assets of the Teachers' Retirement System of the State of Illinois (the System), a component unit of the State of Illinois, as of June 30, 2004 and 2003, and the related statement of changes in plan net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Teachers' Retirement System of the State of Illinois as of June 30, 2004 and 2003, and the changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we will also issue, under separate cover, our report dated November 5, 2004 on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audits.

McGladrey & Pullen, LLP is a member firm of RSM International –
an affiliation of separate and independent legal entities.

The management's discussion and analysis on pages 20 through 25 and the schedules of funding progress and contributions from employers and other contributing entities on pages 41 and 42 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of the System. The introduction section, other supplementary information on page 43, investments section, actuarial section and statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The other supplementary information on page 43 has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole. The introduction, investments, actuarial and statistical sections listed in the table of contents have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

McGladrey & Pullen, LLP

Schaumburg, Illinois
November 5, 2004

Photo courtesy of Sangamon Valley Collection at Lincoln Library



School is a
place where
you learn how
to be a child.
— Nayeli Garcia

Arnold School, Sangamon County — 1943

Management's Discussion and Analysis

Our discussion and analysis of the Teachers' Retirement System of the State of Illinois provides an overview of financial activities for the fiscal year ended June 30, 2004. Please read it in conjunction with the Letter of Transmittal in the Introduction Section on page 7 and the Basic Financial Statements and related notes that follow this discussion.

Financial Highlights

- TRS net assets at June 30, 2004, were \$31.5 billion.
- During FY04, TRS net assets increased \$8.4 billion.
- Contributions from members, employers, and the State of Illinois were \$6,258 million, an increase of \$4,505 million or 256.9 percent during the fiscal year. Please see discussion on treatment of pension obligation bond proceeds under "Contributions" on page 22 and under "Funding" on page 30.
- Total investment income was \$4,486 million, an increase of \$3,425 million or 322.8 percent compared to FY03.
- Benefits and refunds paid to members and annuitants were \$2,310 million, an increase of \$269 million or 13.2 percent compared to FY03.
- The pension benefit obligation or total actuarial accrued liability was \$50.95 billion at June 30, 2004.
- The unfunded actuarial accrued liability decreased from \$23.81 billion at June 30, 2003 to \$19.40 billion at June 30, 2004. The funded ratio increased from 49.3 percent at June 30, 2003 to 61.9 percent at June 30, 2004.

The Basic Financial Statements contained in this section of the *Comprehensive Annual Financial Report* consist of:

Statement of Plan Net Assets. This statement reports the pension trust funds assets, liabilities, and resultant net assets available to pay benefits at the end of the fiscal year. It is the balance sheet of TRS and reflects the financial position of the Teachers' Retirement System as of June 30, 2004.

Statement of Changes in Plan Net Assets. This statement details transactions that occurred during the fiscal year. It is the income statement of TRS and reflects the revenues and expenses recorded throughout the fiscal year. The Statement of Changes in Plan Net Assets supports the change in the value of the net assets reported on the Statement of Plan Net Assets.

Notes to the financial statements. The notes are an integral part of the financial statements and include additional information not readily evident in the statements themselves. The required supplementary information and other schedules following the notes to the financial statements provide historical and additional detailed information considered useful in evaluating the financial condition of the Teachers' Retirement System. The following are condensed comparative financial statements of the TRS pension trust fund.

Condensed Comparative Statement of Plan Net Assets as of June 30

	2004	Percentage Change	2003	Percentage Change	2002
Cash	\$4,269,329	16.9%	\$3,651,963	(39.5%)	\$6,039,088
Receivables and prepaid expenses	353,725,714	23.3	286,769,806	(27.1)	393,200,477
Investments	32,046,373,325	33.9	23,935,615,863	4.3	22,944,918,073
Invested securities lending collateral	3,466,114,601	60.9	2,154,422,658	13.5	1,897,635,461
Capital assets	2,273,510	(13.6)	2,630,930	(15.5)	3,113,533
Total assets	35,872,756,479	36.0	26,383,091,220	4.5	25,244,906,632
Total liabilities	4,328,027,194	32.8	3,258,268,149	13.2	2,878,621,920
Net assets	\$31,544,729,285	36.4%	\$23,124,823,071	3.4%	\$22,366,284,712

Condensed Comparative Statement of Changes in Plan Net Assets For the Year Ended June 30

	2004	Percentage Change	2003	Percentage Change	2002
Contributions	\$6,258,086,538	256.9%	\$1,753,282,676	10.4%	\$1,588,509,682
Total investment income (loss)	4,485,729,345	322.8	1,060,852,111	246.5	(723,987,045)
Total additions	10,743,815,883	281.8	2,814,134,787	225.5	864,522,637
Benefits and refunds	2,310,349,123	13.2	2,041,737,026	13.5	1,798,504,272
Administrative expenses	13,560,546	(2.2)	13,859,402	(9.9)	15,379,736
Total deductions	2,323,909,669	13.1	2,055,596,428	13.3	1,813,884,008
Net increase (decrease) in net assets	8,419,906,214	1010.0	758,538,359	179.9	(949,361,371)
Net assets beginning of year	23,124,823,071	3.4	22,366,284,712	(4.1)	23,315,646,083
Net assets end of year	\$31,544,729,285	36.4%	\$23,124,823,071	3.4%	\$22,366,284,712

Photo courtesy of Abraham Lincoln Presidential Library



To undertake is
to achieve.
— Emily Dickinson

Butler School,
Springfield — 1941

Financial Analysis

TRS was created to provide retirement, survivor, and disability benefits to qualified members. Increases or decreases in plan net assets serve as useful indicators of TRS's financial position. Net assets available to pay benefits were \$31.5 and \$23.1 billion at June 30, 2004 and 2003, respectively. Net assets increased \$8,420 and \$759 million during FY04 and FY03, respectively.

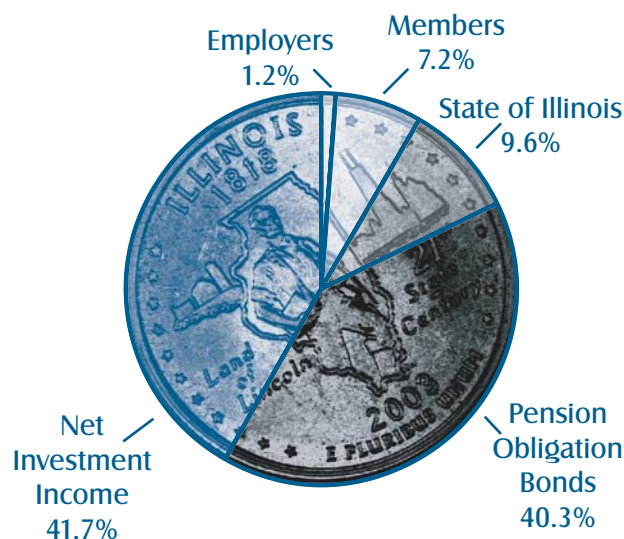
Contributions

Contributions increased \$4,505 and \$165 million during FY04 and FY03, respectively. During FY04, member contributions increased \$37 million and employer contributions from school districts increased \$37 million. During FY03, member contributions increased \$51 million while employer contributions from school districts decreased \$2 million. The decrease in the employer contributions from school districts in FY03 is attributable to a decrease in the employer contribution rate that was effective mid-year FY02 and throughout FY03.

The State of Illinois provides contributions through state appropriations. Receipts from the State of Illinois increased \$4,431 and \$115 million in FY04 and FY03, respectively. The large increase in receipts from the state in FY04 is due to pension obligation bond proceeds TRS received from the State of Illinois. On July 2, 2003, TRS received \$4.330 billion in bond proceeds from the State of Illinois. These funds represented a portion of the \$10 billion of general obligation bonds issued by the State of Illinois for the purpose of reducing the unfunded liabilities for Teachers' Retirement System, State Employees' Retirement System, State Universities Retirement System, General Assembly Retirement System, and Judges' Retirement System.

Please note that the \$4.330 billion in pension obligation bond proceeds presented as contributions in this report are not counted as contributions towards TRS's annual actuarial funding requirements. Beginning with FY05, the computation of the State of Illinois required contribution for a fiscal year will not exceed the State of Illinois contributions that would have been required had the general obligation bond program not been in effect, reduced by the total debt service for each year for the TRS portion of the general obligation bond proceeds.

Revenues by Type for the Year Ended June 30, 2004



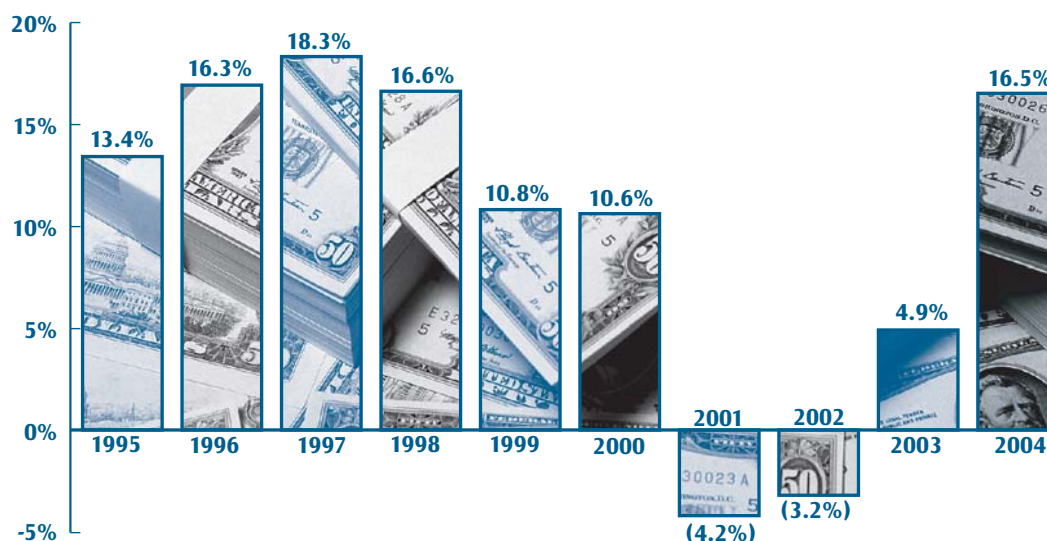
Investments

The TRS trust fund is invested by authority of the Illinois General Assembly under the “prudent person rule” requiring investments to be managed solely in the interest of fund participants and beneficiaries. Principles guiding the investment of funds include preserving the long-term principal of the trust fund and maximizing total return with prudent risk parameters.

The TRS investment portfolio earned its highest one-year return in six years as an improving economy fueled continued strength in the major stock indices. TRS investments earned a 16.5 and 4.9 percent rate of return, net of fees, for FY04 and FY03, respectively. Total investments increased \$8.1 billion from \$23.9 billion at June 30, 2003 to \$32.0 billion at June 30, 2004. The five- and 10-year returns are 4.6 percent and 9.6 percent, respectively. The long-term return continues to outperform the actuarial assumption rate of 8.5 percent.

Through TRS’s disciplined approach to asset allocation and investment manager selection, the fund proved successful in preserving capital during difficult economic times, while showing strong participation during the current market advance. Over the three-year period, TRS ranks in the top decile of large public funds in Callan Associates’ universe, and in the top 12 percent in the Wilshire Trust Universe Comparison Service (TUCS).

Annual Rate of Return (net of investment expenses)



The annual rate of return is an indication of TRS investment performance and is provided by the TRS Master Trustee.

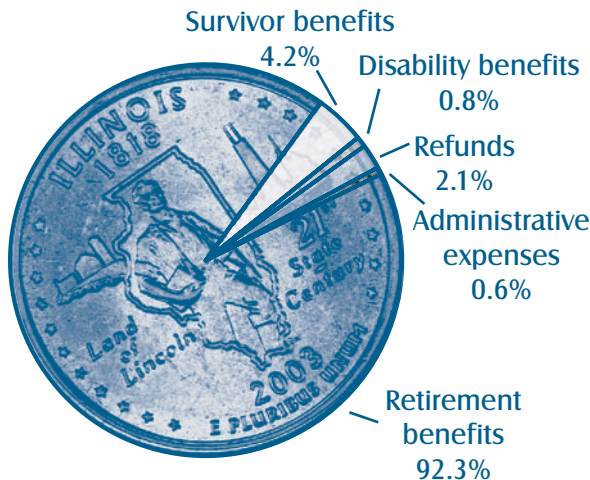
Benefits and Refunds

Survivor, disability, and retirement benefit payments increased \$263 and \$239 million during FY04 and FY03, respectively. During FY04, benefit payments increased from \$1,999 million with 73,431 recipients during FY03 to \$2,262 million with 76,905 recipients. The overall increase in benefit payments is due mainly to an increase in retirement benefit payments. Retirement benefits increased as a result of an automatic 3 percent annual increase in retirement

benefits, an increase in the number of retirees from 64,702 as of June 30, 2003 to 67,950 as of June 30, 2004, and an increase in the final average salaries of teachers that retired during the fiscal year.

Refunds of contributions increased \$5 and \$4 million during FY04 and FY03, respectively. The increase in refunds is a result of increases in 2.2 upgrade contribution refunds, withdrawal of contributions by members leaving teaching, and an increase in survivor benefit refunds.

Expenses by Type for the Year Ended June 30, 2004

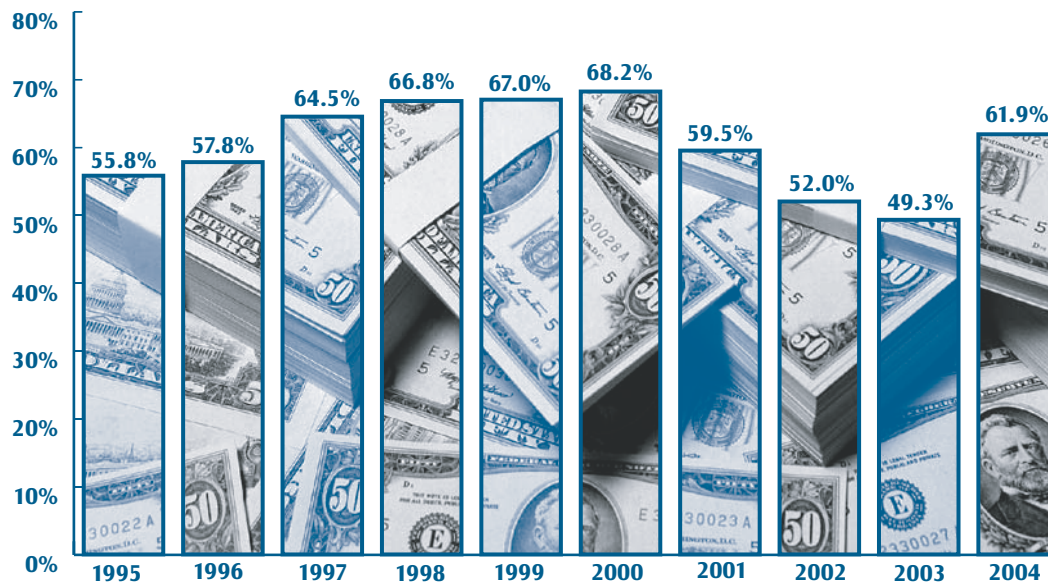


Actuarial

The annual actuarial valuation measures the total liability for all benefits earned to date. The accrued liability is a present value estimate of all the benefits that have been earned to date. The actuarial accrued liability increased \$4.02 and \$3.89 billion during FY04 and FY03, respectively to \$50.95 billion at June 30, 2004 and \$46.93 billion at June 30, 2003. The unfunded liability is the present value of future benefits payable that are not covered by assets as of the valuation date. The unfunded liability decreased \$4.41 billion during FY04 to \$19.40 billion at June 30, 2004 and increased \$3.13 billion during FY03 to \$23.81 billion at June 30, 2003. The funded ratio reflects the percentage of the accrued liability covered by net assets at market value. The funded ratio increased to 61.9 percent at June 30, 2004 from 49.3 percent at June 30, 2003. Decreases in the unfunded liability and increases in the funded ratio indicate an improvement in a system's financial position.

To comply with the Illinois Pension Code, an actuarial experience analysis is performed once every five years to review the actuarial assumptions. In FY02, TRS actuaries conducted an experience analysis of the previous five-year period ended June 30, 2001. The analysis resulted in a decrease in the salary increase assumption, a decrease in the inflation rate assumption, higher rates of retirement, and minor changes in several other assumptions. The net effect of all the actuarial changes decreased the June 30, 2002, actuarial accrued liability by approximately \$346 million compared to the accrued liability that would have been calculated under the old assumptions.

Funded Ratio at Market Value



The ratio of funding is the ratio of assets to liabilities. An increase in this ratio indicates an improvement in TRS's ability to meet future benefit obligations.

Photo by TRS Communications



Larry Sample
30 years of service
Grades 7-12
District 117, Jacksonville

Jane Sample
31 years of service
Grades 7-12
District 117, Jacksonville

The Samples, who will retire within the next two years, plan to spend their retirement relaxing, traveling, and visiting Florida. Jane also plans to read all the books she has "stacked around the house" and possibly volunteering in a library. Larry, an athletic director and assistant principal, will miss the students. "I will miss it all," says Jane, "the students, the enthusiasm, the joy, the heartache and most of all the reward of learning." She has enjoyed teaching English and research skills the most.

Basic Financial Statements

Teachers' Retirement System of the State of Illinois Statement of Plan Net Assets as of June 30, 2004, and 2003

	2004	2003
Assets		
Cash	\$4,269,329	\$3,651,963
Receivables and prepaid expenses		
Member payroll deduction	69,326,056	69,189,321
Member contributions	37,553,098	39,383,845
Employer contributions	13,115,002	7,379,497
State of Illinois	251,416	2,965,709
Investment income	230,705,401	165,638,540
Prepaid expenses	2,774,741	2,212,894
Total receivables and prepaid expenses	353,725,714	286,769,806
Investments, at fair value		
Fixed income	9,089,445,291	7,314,849,657
Equities	18,604,591,222	12,649,352,623
Real estate	2,680,788,703	2,412,293,598
Short-term investments	806,158,043	866,824,921
Private equity investments	840,390,782	668,389,537
Foreign currency	24,999,284	23,905,527
Total investments	32,046,373,325	23,935,615,863
Collateral from securities lending	3,466,114,601	2,154,422,658
Property and equipment, at cost, net of accumulated depreciation of \$5,308,993 and \$6,456,750 in 2004 and 2003, respectively	2,273,510	2,630,930
Total assets	35,872,756,479	26,383,091,220
Liabilities		
Benefits and refunds payable	4,940,452	8,633,145
Administrative and investment expenses payable	97,111,469	75,872,933
Payable to brokers for unsettled trades, net	759,860,672	1,019,339,413
Securities lending transactions	3,466,114,601	2,154,422,658
Total liabilities	4,328,027,194	3,258,268,149
Net assets held in trust for pension benefits	\$31,544,729,285	\$23,124,823,071

(A schedule of funding progress is presented on page 41.)

The accompanying notes are an integral part of these statements.

Photo courtesy of the Abraham Lincoln Presidential Library

Just as time passes, so do
memories pass as well, but those
who stirred our spirits sing in our
hearts forever.
— Unknown

50 year reunion
East St. Louis Senior High School — 1973



Teachers' Retirement System of the State of Illinois
Statement of Changes in Plan Net Assets
Years Ended June 30, 2004, and 2003

	2004	2003
Additions		
Contributions		
Members	\$768,661,300	\$732,020,451
State of Illinois	1,031,477,825	929,709,762
State of Illinois pension obligation bond proceeds	4,330,373,948	0
Employers		
Early retirement	52,495,571	46,773,190
Federal funds	33,651,748	33,354,836
2.2 benefit formula	41,426,146	11,424,437
Total contributions	6,258,086,538	1,753,282,676
Investment income		
From investment activities		
Net appreciation in fair value	3,873,564,792	467,463,329
Interest	278,058,533	343,075,998
Real estate operating income, net	194,324,851	184,785,558
Dividends	206,236,790	139,831,006
Private equity income	27,033,133	8,887,682
Other investment income	3,531,886	3,560,189
Investment activity income	4,582,749,985	1,147,603,762
Less investment expense	(106,418,281)	(92,431,726)
Net investment activity income	4,476,331,704	1,055,172,036
From securities lending activities		
Securities lending income	31,637,926	28,660,317
Securities lending management fees	(2,348,565)	(1,420,317)
Securities lending borrower rebates	(19,891,720)	(21,559,925)
Net securities lending activity income	9,397,641	5,680,075
Total investment income	4,485,729,345	1,060,852,111
Total additions	10,743,815,883	2,814,134,787
Deductions		
Retirement benefits	2,145,187,366	1,890,511,562
Survivor benefits	97,155,092	88,996,829
Disability benefits	19,987,021	19,113,893
Refunds	48,019,644	43,114,742
Administrative expenses	13,560,546	13,859,402
Total deductions	2,323,909,669	2,055,596,428
Net increase	8,419,906,214	758,538,359
Net assets held in trust for pension benefits		
Beginning of year	23,124,823,071	22,366,284,712
End of year	\$31,544,729,285	\$23,124,823,071

The accompanying notes are an integral part of these statements.

Notes to Financial Statements

A. Plan Description

1. Reporting Entity

The Teachers' Retirement System of the State of Illinois (TRS) is the administrator of a cost-sharing multiple-employer defined benefit public employee retirement system (PERS). Membership is mandatory for all full-time, part-time, and substitute public school personnel employed outside of Chicago in positions requiring certification. Persons employed at certain state agencies are also members. Established by the State of Illinois, TRS is governed by the Illinois Pension Code (40 ILCS 5/16). TRS is a component unit of the State of Illinois and is included in the state's financial statements as a pension trust fund.

TRS uses criteria established by the Governmental Accounting Standards Board (GASB) to determine whether other entities should be included within its financial reporting entity. Based on the criteria, TRS includes no other entities in these financial statements.

2. Employers

Members of TRS are employed by school districts, special districts, and certain state agencies. Each employer remits member contributions to TRS. Employers are responsible for employer contributions for teachers paid from federal funds and for the employer's portion of the Early Retirement Option contributions. Effective July 1, 1998, Public Act 90-0582 required employers to pay an employer contribution equal to 0.3 percent of covered payroll during FY99. The contribution was increased to 0.58 percent of covered payroll from July 1, 2000 through December 31, 2001. For the period January 1, 2002 through June 30, 2003, the employer contribution was reduced to 0.18 percent of covered payroll. Effective July 1, 2003, the contribution rate returned to 0.58 percent of covered payroll. In addition, the State of Illinois provides employer contributions. For information about employer contributions made by the State of Illinois, see "Funding" on page 30.

Number of Employers (as of June 30)

	2004	2003
Local school districts	885	890
Special districts	139	141
State agencies	25	27
Total	<u>1,049</u>	<u>1,058</u>

3. Members

TRS Membership (as of June 30)

	2004	2003
Retirees and beneficiaries receiving benefits	76,905	73,431
Inactive members entitled to but not yet receiving benefits	89,641	86,279
Active members	157,990	152,117
Total	<u>324,536</u>	<u>311,827</u>

4. Benefit Provisions

Governed by the Illinois Pension Code (40 ILCS 5/16), which is subject to amendment by the Illinois General Assembly and approval by the Governor, TRS provides retirement, death, and disability benefits. A member qualifies for an age retirement annuity after meeting one of the following requirements: age 62 with five years of service credit; age 60 with 10 years; or age 55 with 20 years. If a member retires between the ages of 55 and 60 with fewer than 35 years of service, the annuity will be reduced at the rate of 0.50 percent for each month the member is under age 60. A member who is age 55 and has fewer than 35 years of service credit may use the Early Retirement Option (ERO) to avoid a discount for early retirement if retirement occurs before July 1, 2005, and within six months of the last day of service requiring contributions, and if the member and employer both make a one-time contribution to TRS. However, both member and employer contributions are waived with 34 years of service. A member with fewer than five years of creditable service and service on or after July 1, 1947, is entitled to a single-sum benefit payable once he or she reaches age 65.

A retirement benefit is determined by the average salary of the four highest consecutive salary rates within the last 10 years of creditable service and the percentage of average salary to which the member is entitled. This percentage is determined by the following formula for service earned before July 1, 1998: 1.67 percent for each of the first 10 years, plus 1.9 percent for each of the next 10 years, plus 2.1 percent for each of the next 10 years, plus 2.3 percent for each year over 30 years. The maximum retirement benefit, 75 percent of average salary, is achieved with 38 years of service under the graduated formula.

Public Act 90-0582 improved retirement benefits for TRS members by changing the rate at which members accrue benefits beginning July 1, 1998, from a graduated rate to a flat rate equal to 2.2 percent of final average salary. Members may attain the maximum 75 percent benefit with 34 years of service under the 2.2 benefit formula. Members retiring on or after the effective date have the option of upgrading their service earned prior to July 1, 1998, to the flat 2.2 percent formula by making a payment to TRS. Additionally, for members who continue to teach, every three full years worked after July 1, 1998, count toward a full one-year reduction of the years to be upgraded.

A money purchase (actuarial) benefit is payable if it results in a higher annuity than either the graduated or 2.2 formula. The 75 percent cap does not apply to the money purchase benefit.

Essentially all retirees receive an annual 3 percent increase in the current retirement benefit beginning January 1 following the attainment of age 61 or January 1 following the first anniversary in retirement, whichever is later.

If a member leaves covered employment, TRS will refund a member's retirement contributions upon request. The refund consists of actual contributions, excluding the 1 percent death benefit contribution.

On June 25, 2002, Governor Ryan signed the State Employee 5&5 Early Retirement Incentive (Public Act 92-0566) into law. Under the terms of this legislation, a TRS member employed by a state agency could elect to purchase five years of service credit and enhanced age. The member had to pay TRS an employee contribution based on the member's highest annual salary

rate used in the determination of final average salary. The required 5&5 contribution had to be deducted from any lump-sum payment at termination. If there was no lump sum or if the lump sum was less than the contribution required, the remaining amount due was treated as a reduction from the retirement annuity in 24 equal monthly installments. A member had to retire between August 1, 2002 and December 31, 2002 unless extended by the agency director to a date no later than April 30, 2003.

5. Funding

Member, employer, and state contributions are statutorily defined by the Illinois Pension Code (40 ILCS 5/16), which is subject to amendment by the Illinois General Assembly and approval by the Governor.

Effective July 1, 1998, member contributions increased from 8 percent to 9 percent of salary. These contributions are allocated as follows: 7.5 percent for retirement, 0.50 percent for post-retirement increases, and 1 percent for death benefits.

Employer contributions are made by or on behalf of the employers from several sources. The State of Illinois provides a large source of contributions through state appropriations from the Common School Fund and Education Assistance Fund. Additional sources of state contributions are the State Pensions Fund and the General Revenue Fund. Effective July 1, 1998, the state began making contributions for the 2.2 benefit formula that are included in statutorily specified minimum state contribution rates. Employers also make contributions for the 2.2 benefit formula and for teachers who are paid from federal funds. Additionally, employers contribute their portion of the cost of the Early Retirement Option.

On April 7, 2003, Public Act 93-0002 authorized the State of Illinois to issue \$10 billion in general obligation bonds for the purpose of making contributions to designated retirement systems. TRS was one of the designated retirement systems for the purpose of this new law. In addition, the Pension Contribution Fund was created as a special fund in the State Treasury.

On June 12, 2003, the State of Illinois issued \$10 billion in general obligation bonds, pension funding series of June 2003, and deposited the net bond proceeds of \$7,317,292,916 into the Pension Contribution Fund. Bond proceeds of \$2,682,707,084 were utilized

- to reimburse the General Revenue Fund \$2,160,000,000 for the last quarter of the state's FY03 required contributions and the total FY04 required contributions to the designated retirement systems, and
- to fund \$481,038,334 in interest payments due December 1, 2003 and June 1, 2004 on the general obligation bonds, pension funding series of June 2003, and
- to fund bond issuance and other costs totaling \$41,668,750.

The net bond proceeds of \$7,317,292,916 were allocated among the five state-funded retirement systems to reduce their actuarial reserve deficiencies as provided in Public Act 93-0002. Pursuant to the amendments to the General Obligation Bond Act (30 ILCS 330/7.2), the Governor's Office of Management and Budget determined the percentage distribution of the proceeds. The allocation of the proceeds was based on the percentage distribution of the state's total actuarial reserve deficiency as of June 30, 2002.

TRS received an allocation of bond proceeds equal to \$4,330,373,948 on July 1, 2003. The monies were deposited into TRS's Master Trust account with The Northern Trust Company on July 2, 2003.

The \$4.33 billion in pension obligation bond proceeds presented as contributions in this report are not counted as contributions towards TRS's annual actuarial funding requirements. Beginning with FY05, the computation of the State of Illinois required contribution for a fiscal year will not exceed the State of Illinois contributions that would have been required had the general obligation bond program not been in effect, reduced by the total debt service for each year for the TRS portion of the general obligation bond proceeds.

The actuarial funding requirements for FY04 and FY03 were determined under Public Act 90-0582. State funding law provides for a 50-year funding plan that includes a 15-year phase-in period. Minimum state contribution rates are specified in the statute for FY99 through FY04. Public Act 93-0002, first effective in FY05, establishes a procedure for calculating state contributions after the receipt of pension obligation bond proceeds in early FY04. This procedure will continue through FY33. TRS's funded ratio will be 90 percent at the end of the 50-year period. Beginning July 1, 1995, state contributions have been made through a continuing appropriation instead of through the appropriations process.

Administrative expenses are budgeted and approved by the TRS Board of Trustees. Funding for these expenses is included in the employer contribution, as determined by the annual actuarial valuation.

B. Summary of Significant Accounting Policies

1. Basis of Accounting

TRS's financial statements are prepared using the accrual basis of accounting. Member and employer contributions are recognized as revenues in the period in which member services are performed pursuant to formal commitments, as well as statutory or contractual requirements. Benefits and refunds are recognized as expenditures when they are due and payable in accordance with the terms of the plan.

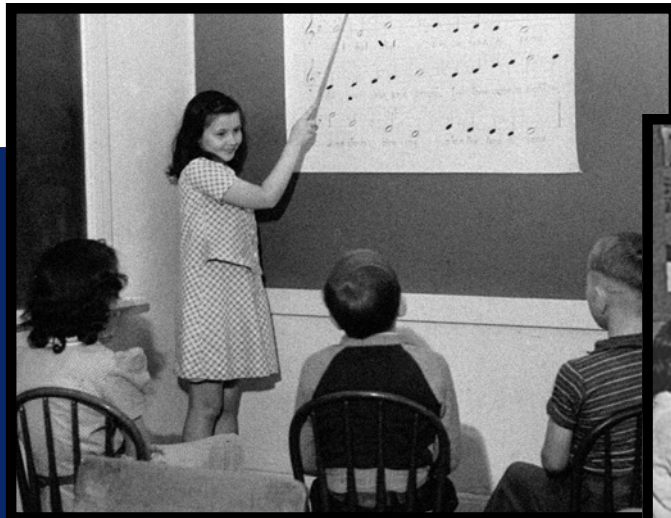


Photo courtesy of Rockford Public Library



It takes a long time to bring excellence to maturity.

— Publius Syrus

Rockford Auburn High School —1966

2. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions to and deductions from net assets during the reporting period. Actual results could differ from those estimates.

3. New Accounting Pronouncements

In March 2003, the Governmental Accounting Standards Board (GASB) issued Statement No. 40, "Deposit and Investment Risk Disclosures" an amendment of GASB Statement No. 3. The statement establishes and modifies disclosure requirements related to investment risks: credit risk (including custodial credit risk and concentrations of credit risk), interest rate risk, and foreign currency risk. This statement also establishes and modifies disclosure requirements for deposit risks: custodial credit risk, and foreign currency risk. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2004.

In May 2004, GASB issued Statement No. 44, "Economic Condition Reporting: The Statistical Section," an amendment of NCGA Statement 1. The statement establishes and modifies requirements related to the supplementary information presented in the statistical section. The requirements of this statement are effective for statistical sections prepared for periods beginning after June 15, 2005.

In June 2004, GASB issued Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions" (OPEB). The statement establishes standards of accounting and financial reporting for OPEB expense/expenditures and related OPEB liabilities or assets, note disclosures, and required supplementary information (RSI) in the financial reports of state and local government employers. The requirements of this statement are effective for TRS's financial statements for periods beginning after December 16, 2006.

4. Method Used to Value Investments

TRS reports investments at fair value. Fair value for equities is determined by using the closing price listed on national and over-the-counter securities exchanges as of June 30. Fair value for fixed income securities is determined principally by using quoted market prices provided by independent pricing services. Fair value for real estate investments is determined by appraisals. Fair value for private equity assets is determined by the general partner in accordance with the provisions of the individual equity agreements.

5. Property and Equipment

Equipment is stated on the basis of historical cost. Depreciation is computed using the straight-line method based upon the estimated useful lives of the assets. Office furniture and equipment are assigned a useful life of three to 10 years while vehicles are assigned a five-year life. TRS's office building is depreciated over 40 years.

6. Accrued Compensated Absences

When they terminate employment, TRS employees are entitled to receive compensation for all accrued but unused vacation time and one-half of all unused sick leave earned through December 31, 1997. (Lump-sum payments for sick leave earned prior to January 1, 1984, are

subject to a maximum of 60 days or 420 hours.) Accrued compensated absences as of June 30, 2004, and 2003 totaled \$1,311,493 and \$1,390,654 respectively, and are included as administrative and investment expenses payable.

7. Receivables

Receivables consist primarily of 1) member and employer contributions owed and yet to be remitted by the employing districts as of June 30 and 2) interest, dividends and real estate income owed to TRS as of June 30.

TRS assesses penalties for late payment of contributions and may collect any unpaid amounts from the employing districts by filing a claim with the regional superintendent of education or the Office of the Comptroller against future state aid payments to the employer. TRS considers these amounts to be fully collectible.

Members may enter into Payroll Deduction Program agreements with their employers to pay for their optional service balances, to repay refunds previously taken from TRS, to pay for their 2.2 benefit formula upgrade balances, or to pay estimated ERO contributions. Terms and conditions of the agreements are:

- A member must be employed full time.
- The agreement is irrevocable and can be terminated only upon full payment of the member's balance or upon the member's death, disability, retirement, or termination of employment.
- The amount deducted must be a minimum of \$50 per month and cannot be changed during the term of the agreement.
- Agreements may begin at the beginning of each calendar year quarter.
- The member may not make direct payments to TRS to reduce the balance under which an agreement has been entered.

If the agreement is to pay for a 2.2 formula upgrade balance, the maximum length of the agreement is 60 months. TRS had outstanding balances in payroll deduction agreements totalling \$69,326,056 and \$69,189,321 as of June 30, 2004, and 2003 respectively.

8. Prior Period Reclassification

Certain prior year amounts have been reclassified on a basis consistent with the current year presentation.

C. Cash

The bank balance and carrying amount of TRS's deposits were \$4,076,472 and \$4,269,329 at June 30, 2004, and \$3,353,886 and \$3,651,963 at June 30, 2003. Of the bank balance, \$3,654,191 and \$1,764,260 were on deposit with the state treasurer at June 30, 2004, and 2003, respectively. Bank balances are either insured or collateralized with securities held by the state treasurer or agents in the name of the state treasurer or are collateralized with securities held by TRS or its agents in the name of TRS. Cash equivalents are classified as short-term investments in the Statement of Plan Net Assets.

D. Investments

1. Investment Policies

Through the Board of Trustees, as authorized in the Illinois Pension Code, TRS serves as fiduciary for the members' trust funds and is responsible for investment of those funds by authority of the "prudent person rule." This rule establishes a standard for all fiduciaries by specifying fiduciary responsibility with regard to the members' trust funds.

2. Investment Summary

The Investment Summary table presents a summary of TRS investments and related category of custodial credit risk at June 30, 2004, and 2003. TRS investments are categorized to give an indication of the level of risk at year end.

Investment Summary

	2004	<u>Fair Value</u> 2003
Category 1		
Government obligations	\$2,992,342,969	\$2,621,779,743
Corporate obligations	2,781,005,549	2,581,192,122
Preferred stock	170,070,365	122,216,598
Short-term investments		
Commercial paper (including short-term collateral and other)	281,155,980	131,576,415
U.S. Treasury bills	184,345,628	110,756,857
Common stock	9,945,656,333	6,389,798,694
	16,354,576,824	11,957,320,429
Not Categorized		
Investments held by broker-dealers under securities loans		
Government obligations	1,846,377,712	881,558,768
Corporate obligations	267,699,827	227,264,276
Common stock	1,807,112,830	1,296,002,734
Real estate equity	2,472,890,408	2,272,624,364
Mutual funds	7,908,442,896	5,874,851,004
Private equity investments		
Limited partnerships	840,390,782	668,389,537
Foreign currency	24,999,284	23,905,527
Collective investment funds (U.S. dollars)	525,002,063	735,248,505
Security lending short-term collateral investment pool	3,464,995,300	2,152,873,377
Investments and collateral from securities lending	35,512,487,926	26,090,038,521
Less collateral from securities lending	(3,466,114,601)	(2,154,422,658)
Total investments*	\$32,046,373,325	\$23,935,615,863

* This total does not include accrued income.

Category 1 includes investments that are insured or registered, or for which the securities are held by TRS or its agent in the name of TRS. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department in TRS's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty but not in TRS's name. As of June 30, 2004, and 2003, TRS holds no securities classified in either Category 2 or Category 3.

TRS has nonrecourse mortgages totalling \$982,913,430 and \$614,593,685 on real estate equities at June 30, 2004, and 2003, respectively. The amount reported for real estate equity is net of these mortgages, which mature on various dates through the year 2025.

The real estate equity category includes no mortgages receivable at June 30, 2004, and \$5,575,540 of mortgages receivable which were fully secured by the properties at June 30, 2003.

At June 30, 2004, and 2003, TRS did not have any investments in one organization that exceeded 5 percent of net assets held in trust for pension benefits.

3. Securities Lending Program

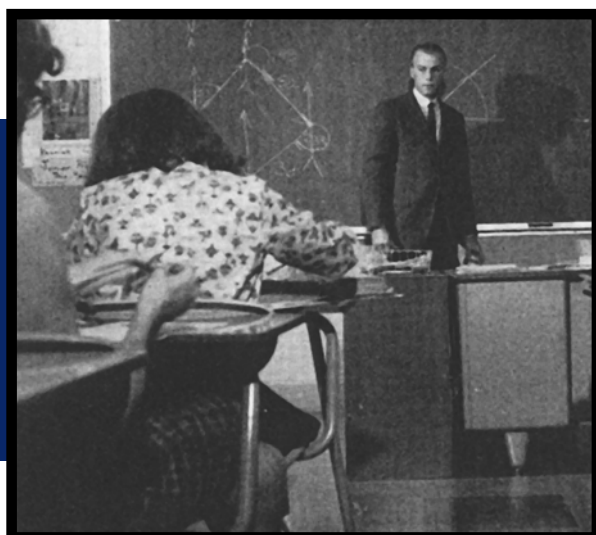
The Board of Trustees' policies permit TRS to use investments to enter into securities lending transactions — loans of securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. TRS's master trustee is the agent in lending the plan's domestic securities for cash collateral of 102 percent of the market value of the securities and international securities for cash collateral of 105 percent of the market value of the securities. Securities on loan at year-end are presented as not categorized in the preceding schedule of custodial credit risk.

At year-end, TRS has no credit risk exposure to borrowers because the amount TRS owes the borrowers exceeds the amount the borrowers owe TRS. The contract with TRS's lending agent requires the agent to indemnify TRS if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay TRS for income distributions by the securities issuers while the securities are on loan. All securities loans can be terminated on demand either by TRS or the borrower, although the average term of the loans is 65 days. In lending domestic securities, cash collateral is invested in the lending agent's short-term investment pool, which at year-end has a weighted average maturity of 51 days. There were no significant violations of legal or contractual provisions, and there were no borrower or lending agent default losses known to the securities lending agent.

As of June 30, 2004, and 2003, TRS had outstanding loaned investment securities having a market value of \$3,921,190,369 and \$2,404,825,778, respectively, against which it had received collateral of \$4,024,263,673 and \$2,487,998,438, respectively. Collateral from securities lending reflected on the Statement of Plan Net Assets consists primarily of collateral received in the form of cash.

4. Derivatives

TRS invests in derivative securities. A derivative security is an investment whose return depends upon the value of other assets such as commodity prices, bond and stock prices, or a market index. To varying degrees, derivative transactions involve credit risk and market risk.



Patience is the companion
of wisdom.
— Saint Augustine

Rockford Auburn High School — 1966

Photo courtesy of Rockford Public Library

Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to the established terms. To eliminate credit risk, derivative securities are generally acquired through a clearinghouse that guarantees delivery and accepts the risk of default by either party.

Market risk is the possibility that a change in interest or currency rates will cause the value of a financial instrument to decrease or become more costly to settle. Imposing limits on the types, amounts, and degree of risk that investment managers may undertake regulates the market risk associated with the constantly fluctuating prices of derivatives. These limits are approved by the Board of Trustees and senior management, and the derivative positions of the investment managers are reviewed on a regular basis to monitor compliance with the limits.

During the year, TRS's derivative investments included foreign currency forward contracts, index futures, cash equivalent futures and options. Derivative contracts are used by experienced investment personnel to implement tactical strategies upon the portfolio in a cost-effective manner.

Foreign Currency Forward Contracts

Objective: Foreign currency forward contracts are agreements to exchange the currency of one country for the currency of another country at an agreed-upon price and settlement date. TRS uses these contracts primarily to hedge the currency exposure of its investments.

Terms: Foreign currency forward contracts are in the form of either forward purchases or forward sales of foreign currency. Forward purchases obligate the System to purchase specific foreign currency at an agreed upon price. Forward sales obligate the System to sell specific foreign currency at an agreed upon price. At June 30, 2004, foreign currency forward purchase or sell contracts included primarily the following currencies: Swedish krona, euro, Japanese yen, Canadian dollar, Swiss franc, British pound sterling, Danish krone, Australian dollar and U.S. dollar. These contracts have various settlement dates within twelve months of June 30, 2004.

Fair Value: As of June 30, 2004, and June 30, 2003, TRS's open foreign currency forward contracts had a net negative fair value of (\$3,011,319) and (\$464,426), respectively.

Market Value	June 30, 2004	June 30, 2003
Forward currency purchases	\$361,979,928	\$578,413,212
Forward currency sales	(364,991,247)	(578,877,638)
Unrealized gain/(loss)	<u>(\$3,011,319)</u>	<u>(\$464,426)</u>

Financial Futures

Objective: Financial futures are agreements to purchase or sell a specific amount of an asset at a specified delivery or maturity date for an agreed upon price. These derivative securities are used to improve yield, adjust the duration of the fixed income portfolio, circumvent changes in interest rates, or to replicate an index.

Terms: Futures contracts are standardized and traded on organized exchanges, thereby minimizing TRS's credit risk. As the market value of the futures contract varies from the original contract price, a gain or a loss is recognized and paid to or received from the clearinghouse. At June 30, 2004 and June 30, 2003, TRS had outstanding futures contracts with an underlying notional value of \$2,343,330,544 and \$1,149,927,012, respectively. Contractual principal values do not represent the actual values in the Statement of Plan Net Assets. The contracts have various expiration dates through June 2006.

Fair Value: Gains and losses on futures contracts are settled daily based on the change of the index or commodity price for the underlying notional value. Because of daily settlement, the futures contracts have no fair value.

Type	FY04 Number of Contracts	FY04 Contractual Principal	FY03 Number of Contracts	FY03 Contractual Principal
Fixed Income Index Futures (net)	3,535	\$386,724,250	269	\$31,576,813
International Fixed Income Index Futures (net)	406	132,428,606	69	8,980,674
Stock Index Futures (net)	10,267	1,416,098,300	3,998	972,813,350
Cash Equivalent (Eurodollar) Futures (net)	1,692	408,079,388	554	136,556,175
Total	15,900	\$2,343,330,544	4,890	\$1,149,927,012

Financial Options

Objective: Financial options are agreements that give one party the right, but not the obligation, to buy or sell a specific amount of an asset for a specified price, called the strike price, on or before a specified expiration date. As a writer of financial options, TRS receives a premium at the outset of the agreement and bears the risk of an unfavorable change in the price of the financial instrument underlying the option. Accordingly, it is against TRS policy to invest in any uncovered options. Premiums received are recorded as a liability when the financial option is written.

Terms: At June 30, 2004, TRS had outstanding options contracts with an underlying notional value of \$15,793,550. Contractual principal values do not represent the actual values in the Statement of Plan Net Assets. The contracts have various expiration dates through December 2004.

Fair Value: Fluctuations in the fair value of financial options are recognized in TRS's financial statements as incurred rather than at the time the options are exercised or when they expire. As of June 30, 2004, and June 30, 2003, the fair value of option contracts written was (\$288,983) and (\$464,047), respectively. The fair value represents the amount needed to close all positions as of that date. The table below presents the aggregate contractual principal (notional value) of TRS's outstanding contracts at June 30, 2004, and June 30, 2003.

Type	FY04 Number of Contracts	FY04 Contractual Principal	FY04 Fair Value	FY03 Number of Contracts	FY03 Contractual Principal	FY03 Fair Value
Fixed Income Written Call Options	532	\$10,536,700	(\$201,938)	367	\$9,093,000	(\$68,797)
Fixed Income Written Put Options	308	4,826,850	(86,026)	4,178	7,939,000	(327,125)
International Fixed Income Written Put Options	67	430,000	(1,019)	0	0	0
Cash Equivalent Written Put Options (Eurodollar)	0	0	0	650	8,152,500	(68,125)
Total	907	\$15,793,550	(\$288,983)	5,195	\$25,184,500	(\$464,047)

Contractual principal amounts are often used to express the volume of these transactions but do not reflect the extent to which positions may offset one another. These amounts do not represent the much smaller amounts potentially subject to risk.

E. Reserves

TRS maintains statutory reserve accounts in accordance with the provisions of 40 ILCS 5/16-101 *et seq.* In 1997, the Illinois General Assembly passed legislation that allowed the crediting of income at fair value, as opposed to book value, to the Employer's Contribution Reserve.

At June 30, 2003, the Members' Contribution Reserve and Employer's Contribution Reserve balances were \$9,780,678,167 and \$13,340,425,158 respectively. In 2003, the Illinois General Assembly passed legislation to allow the Members' and Employer's Contribution Reserves to be combined into a new Benefit Trust Reserve effective July 1, 2003.

1. Benefit Trust

	2004	2003
Balances at June 30	\$31,540,767,937	\$23,121,103,325

This reserve serves as a clearing account for TRS income and expenses. The reserve is credited with contributions from the State of Illinois that are not specifically allocated to the Minimum Retirement Annuity Reserve, member and employer contributions, income from TRS invested assets, and contributions from annuitants who qualify for automatic annual increases in annuity.

The reserve accumulates, with 6 percent interest, the contributions by members prior to retirement. Contributions have been 7.5 percent of salary since July 1, 1998. Contributions are fully refundable upon withdrawal from TRS, excluding interest credited thereon. The interest accrued is refundable only in the event of death. Interest is credited as of the date of retirement or death of those retiring or dying during the year and as of the end of the fiscal year for all other members. Interest is computed annually based upon the individual member's balance in the reserve at the beginning of the fiscal year.

This reserve is charged for transfers to the Minimum Retirement Annuity Reserve and all

- refunds to withdrawing members,
- retirement annuity payments (except as provided by the Minimum Retirement Annuity Reserve),
- benefits that are paid to temporarily or accidentally disabled members,
- death benefits paid, and
- refunds to annuitants for survivor benefit contributions.

The expected benefit payments do not equal the present value of the reserve. The additional amount needed (the unfunded actuarial accrued liability) as calculated by the actuary was \$19,402,722,000 in 2004 and \$23,808,609,000 in 2003.

2. Minimum Retirement Annuity

	2004	2003
Balances at June 30	\$3,961,348	\$3,719,746

The minimum annuity is set by law at \$25 per month for each year of creditable service to a maximum of \$750 per month after 30 or more years of creditable service. To qualify, annuitants are required to make a one-time contribution that is credited to the reserve. Interest at 6 percent is credited to the reserve annually based upon the average reserve balance. The State of Illinois also appropriated funds necessary to pay the minimum benefits provided in the legislation. All benefits paid under this program are charged to the reserve. This reserve is fully funded.

F. TRS Employee Pension Benefits

1. Plan Description

All full-time TRS employees who are not eligible to participate in TRS participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. SERS is a single-employer defined benefit public employee retirement system (PERS) in which state employees participate, except those who are covered by the State Universities Retirement System, Teachers' Retirement System, General Assembly Retirement System, and Judges' Retirement System. SERS's financial position and results of operations for FY04 and FY03 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the years ended June 30, 2004, and 2003, respectively. SERS also issues a separate CAFR that may be obtained at www.state.il.us/srs, by writing to SERS, 2101 South Veterans Parkway, Springfield, Illinois 62794-9255, or by calling (217) 785-7444. The State of Illinois CAFR may be obtained at www.ioc.state.il.us, by writing to Office of the Comptroller, Financial Reporting Department, 325 West Adams Street, Springfield, Illinois 62704-1858, or by calling (217) 782-2053.

A summary of SERS's benefit provisions; changes in benefit provisions; employee eligibility requirements, including eligibility for vesting; and the authority under which benefit provisions are established are included as an integral part of the SERS CAFR. Also included is a discussion of employer and employee obligations to contribute and the authority under which those obligations are established.

Photo courtesy of the Abraham Lincoln Presidential Library



The love of learning, the
sequestered nooks, and
all the sweet serenity of
books.
— Longfellow

Park School, East St. Louis — 1965

2. Funding Policy

TRS pays employer retirement contributions to SERS based on an actuarially determined percentage of the TRS employee payroll representing TRS employees who are members of SERS. For FY04, FY03, and FY02, the SERS employer contribution rates were 13.439 percent, 10.321 percent, and 10.040 percent, respectively. TRS made the required contributions to SERS for the current year and each of the two preceding years. TRS contributions for the years ending FY04, FY03, and FY02 were \$662,711, \$541,552, and \$529,400, respectively. Effective for pay periods beginning after July 1, 1993, the TRS Board of Trustees opted to pay the employee contribution for all employees. The contribution pickup (4 percent for SERS members, 9 percent for TRS members beginning in FY02 and 8 percent for TRS members in prior years) was included in the FY04 and FY03 administrative budgets approved by the board.

TRS pays an employer contribution for its employees who are members of TRS. Additional employer contributions for these employees are paid by the State of Illinois and are included in the annual state contribution to TRS.

3. Post-Employment Benefits – TRS Employees

In addition to providing pension benefits, the State Employees Group Insurance Act of 1971 requires certain health, dental, and life insurance benefits be provided by the state. Substantially, all TRS employees may become eligible for post-employment benefits if they eventually become annuitants. Health and dental benefits include basic benefits for TRS retirees under the state's self-insurance plan and insurance contracts currently in force. Life insurance benefits are limited to \$5,000 per annuitant who is age 60 or older.

Costs incurred for health, dental, and life insurance for annuitants and their dependents were not separated from benefits that were provided to active employees and their dependents for the years ended June 30, 2004, and 2003. However, post-employment costs for the state as a whole for all state agencies or departments for dependent health, dental, and life insurance for annuitants and their dependents are disclosed in the state's Comprehensive Annual Financial Report. Cost information for retirees by individual state agency is not available. Payments are made on a "pay-as-you-go" basis.

Photo courtesy of the Abraham Lincoln Presidential Library



A teacher affects eternity;
he can never tell where his
influence stops.
— Henry Adams

Floraville School,
St. Clair County — 1964

Required Supplementary Information

Schedule of Funding Progress¹

Actuarial Valuation Date	Actuarial Value of Assets (a)	Accrued Liability (AAL-Projected Unit Credit) (b)	Funded Ratio (a)/(b)	Unfunded Actuarial Accrued Liability (UAAL) (b) - (a)	Covered Payroll (c)	Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll (b-a)/(c)
6/30/96	\$15,103,927,000	\$26,141,794,000	57.8%	\$11,037,867,000	\$4,734,250,000	233.1%
6/30/97	17,393,108,000	26,951,585,000	64.5	9,558,477,000	5,013,583,000	190.7
6/30/98	19,965,887,000	29,908,241,000	66.8	9,942,354,000	5,323,403,000	186.8
6/30/99	22,237,709,000	33,205,513,000	67.0	10,967,804,000	5,698,117,000	192.5
6/30/00	24,481,413,000	35,886,404,000	68.2	11,404,991,000	6,062,884,000	188.1
6/30/01	23,315,646,000	39,166,697,000	59.5	15,851,051,000	6,430,612,000	246.5
6/30/02	22,366,285,000	43,047,674,000	52.0	20,681,389,000	6,785,236,000	304.8
6/30/03	23,124,823,000	46,933,432,000	49.3	23,808,609,000	7,059,032,000	337.3
6/30/04	31,544,729,000	50,947,451,000	61.9	19,402,722,000	7,280,795,000	266.5

Schedule of Contributions from Employers and Other Contributing Entities¹

Year Ended June 30	State Contributions ²	Federal and Employer Contributions ²	Total	Annual Required Contribution per GASB Statement #25	Percentage Contributed	Annual Required Contribution per State Statute	Percentage Contributed
1996	\$324,276,000	\$16,997,000	\$341,273,000	\$1,350,997,000	25.3%	\$341,276,000	100.0%
1997	377,969,000	17,379,000	395,348,000	927,842,000	42.6	395,269,000	100.0
1998	460,439,000	17,246,000	477,685,000	983,312,000	48.6	478,439,000	99.8
1999	567,068,000	36,535,000	603,603,000	932,909,000	64.7	592,547,000	101.9
2000	634,039,000	54,547,000	688,586,000	1,003,612,000	68.6	686,384,000	100.3
2001	719,357,000	58,985,000	778,342,000	1,102,441,000	70.6	775,732,000	100.3
2002	810,619,000	51,270,000	861,889,000	1,163,262,000	74.1	872,283,000	98.8
2003	926,066,000	44,779,000	970,845,000	1,427,519,000	68.0	963,858,000	100.7
2004	1,028,259,000	75,078,000	1,103,337,000	1,716,977,000	64.3	1,100,264,000	100.3

1 For consistency with figures reported by TRS's actuaries, the amounts have been rounded to the nearest thousand. Actual contributions varied slightly from contributions that are required by statute mainly because of differences between estimated and actual federal contributions.

Pension obligation bonds are not treated as a state contribution in FY04 because they do not count towards the annual funding requirement calculated by the actuary. In FY03, the annual contributions required per state statute is the state funding requirement certified after Public Act 92-0505 was enacted. The diversion to THIS Fund was effective for the entire fiscal year. In FY02, the annual contribution required per state statute is the state funding requirement certified before Public Act 92-0505 was enacted. This act allowed districts to reduce their contributions to TRS by the amount they contributed to the Teachers' Health Insurance Security Fund. The diversion was effective January 1, 2002 through June 30, 2003.

2 Excludes employer ERO and ERI payments, minimum retirement, and supplemental annuity contributions. Beginning in FY01, the supplemental annuity appropriation was not requested. These amounts are not counted for actuarial purposes.

See accompanying Independent Auditors' Report.

Education is not a preparation for life;
education is life itself.
— John Dewey

Monroe Grade School, East St. Louis — 1963

Photo courtesy of the Abraham Lincoln Presidential Library



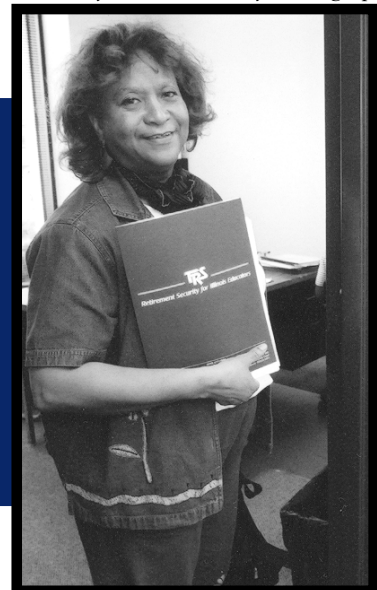
Notes to Required Supplementary Information

Valuation Dates	June 30, 2004	June 30, 2003
Actuarial cost method:	Projected unit credit	Projected unit credit
Amortization method:		
a) For GASB Statement #25 reporting purposes	Level percent of payroll	Level percent of payroll
b) Per state statute	15-year phase-in to a level percent of payroll until a 90% funding level is achieved	15-year phase-in to a level percent of payroll until a 90% funding level is achieved
	Minimum state contribution rates in statute include cost 2.2 benefit formula change as a level percent of payroll	Minimum state contribution rates in statute include cost 2.2 benefit formula change as a level percent of payroll
Remaining amortization period:		
a) For GASB Statement #25 reporting purposes	40 years, open	40 years, open
b) Per state statute	41 years, closed	42 years, closed
Asset valuation method:	Fair value	Fair value
Actuarial assumptions:		
Investment rate of return	8.5%	8.5%
Projected salary increases	5.9-10.1% composite 6.5%	5.9-10.1% composite 6.5%
Group size growth rate	0%	0%
Assumed inflation rate	3.5%	3.5%
Post-retirement increase	3% compounded	3% compounded
Mortality table	1995 Buck Mortality Tables (rated forward three years for male benefit recipients only)	1995 Buck Mortality Tables (rated forward three years for male benefit recipients only)

See accompanying Independent Auditors' Report.

Photo by Michael Bracey Photography

Grace Barnes has 40 years of service, teaching 1st, 2nd, 4th, 5th and 6th grades in La Grange Park School District 102 and in schools in Chicago and Indiana. Retired for only seven days when this photo was taken, Grace will miss the children. She enjoyed teaching language arts and social studies the most. Grace looks forward to traveling, a new home, and grandchildren someday... if her children ever get married.



Other Supplementary Information

Schedule of Administrative Expenses For Years Ended June 30

	2004	2003
Personal services	\$9,855,223	\$9,499,683
Professional services	981,402	1,385,493
Postage	436,283	488,524
Machine repair and rental	503,353	553,562
Other contractual services	792,565	716,257
Commodities	435,978	488,669
Occupancy expense	182,991	194,205
Depreciation	372,751	532,511
Loss on disposal of equipment	0	498
Total administrative expenses	\$13,560,546	\$13,859,402

Schedule of Investment Expense For Years Ended June 30

	2004	2003
Investment manager fees	\$93,944,558	\$71,646,159
Private equity investment expense	10,645,742	18,614,717
Miscellaneous	1,827,981	2,170,850
Total investment expense	\$106,418,281	\$92,431,726

Schedule of Payments to Consultants For Years Ended June 30

	2004	2003
Actuarial services	\$204,154	\$149,870
External auditors	112,142	110,226
Legal services	129,844	273,951
Management consultants		
Information systems	481,315	692,086
TRS STAR audit	0	6,234
Benchmarking	0	25,000
Salary review	0	250
Executive search	0	76,226
403(b) survey	0	25,000
Member satisfaction survey	0	20,000
Board and staff training	27,548	0
Operations	23,289	0
Other	3,110	6,650
Total payments to consultants	\$981,402	\$1,385,493

See accompanying Independent Auditors' Report.



Rick

Schairer

30 years
of service

Photo by Michael Bracey Photography

Rick Schairer teaches 5th and 6th grade in Kaneland School District 302 in Maple Park. He's enjoyed teaching social studies and math. Although he'll miss his peers and especially the kids, he looks forward to retirement. He plans to travel with his family and take a freighter cruise with a couple of his retired colleagues. He also plans to substitute teach.